

**REPORT ON EXAMINATION**  
**OF**  
**DELAWARE AMERICAN LIFE**  
**INSURANCE COMPANY**  
**AS OF**  
**DECEMBER 31, 2006**

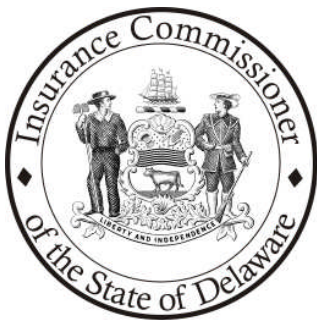
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2006 of the

**DELAWARE AMERICAN LIFE INSURANCE COMPANY**

is a true and correct copy of the document filed with this Department.

ATTEST BY: Antoinette Hardy

DATE: 30 MAY 2008



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 30TH DAY OF MAY, 2008.

Matthew Denn  
Insurance Commissioner

**REPORT ON EXAMINATION**  
OF THE  
**DELAWARE AMERICAN LIFE INSURANCE COMPANY**  
AS OF  
**December 31, 2006**

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matt Denn", is positioned above a horizontal line.

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MATTHEW DENN  
INSURANCE COMMISSIONER

DATED this 30TH Day of MAY 2008.

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March 6, 2008

Honorable Matthew Denn  
Commissioner of Insurance  
State of Delaware  
841 Silver Lake Boulevard  
Dover, Delaware 19904

Dear Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 07.011, dated April 11, 2007, an examination has been made of the affairs, financial condition and management of

**DELAWARE AMERICAN LIFE INSURANCE COMPANY**

hereinafter referred to as the "Company" incorporated under the laws of the state of Delaware as a stock company with its statutory office located at One Alico Plaza, Wilmington, Delaware. The examination was conducted at the main administrative office of the Company located at 2727-A Allen Parkway, Houston, Texas. The report of such examination is submitted herewith.

**SCOPE OF EXAMINATION**

The last examination was conducted as of December 31, 2003. This comprehensive financial examination covered the period January 1, 2004, through December 31, 2006, and consisted of a general survey of the Company's business policies and practices, management, any corporate matters incident thereto, a verification and evaluation of assets and a determination of liabilities. Transactions subsequent to the latter date were reviewed where deemed necessary.

This report is presented on the exception basis. It is designed to set forth the facts with regard to any material adverse findings disclosed during the examination. The text will explain

changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible Company Officials during the course of the examination.

The general procedure of the examination followed the rules established by the National Association of Insurance Commissioners' (NAIC) Committee on Financial Condition Examiners Handbook, and generally accepted statutory insurance examination standards.

In addition to the items hereinafter incorporated as part of the written report, the following were checked and made part of the work papers of this examination:

- Corporate Records
- Fidelity Bonds and Other Insurance
- Officers', Employees', and Agents' Welfare and Pension Plans
- Conflict of Interest
- Business in force by States
- Legal Actions
- NAIC Financial Ratios
- Subsequent Events
- All Asset and Liability Items not mentioned in this report

Work papers prepared by the Company's external accounting firm, PricewaterhouseCoopers, (PWC) New York, New York, in connection with the annual audit, were reviewed and relied upon to the extent possible.

INS Services, Inc. was retained by the Delaware Department of Insurance to conduct a review of the Company's overall control risk related to information system controls.

The Company was examined concurrently with an affiliate, AIG Life Insurance Company.

## **HISTORY**

The Company was incorporated under the laws of the state of Delaware on November 4, 1964, as a subsidiary of American Life Insurance Company (ALICO), and commenced business

on August 1, 1966. The Company is licensed to write the business of life, annuities and accident and health insurance as provided by the laws of Delaware. The Company became a member of the American International Group, Inc. (AIG) holding company system in 1968 when ALICO was acquired by AIG. In 1992, the Company became a direct, wholly owned subsidiary of AIG when it was acquired from ALICO as a dividend.

#### Capitalization

Common capital stock totaled \$2,500,000 during the period under examination. AIG, an insurance holding company domiciled in the state of Delaware, owns 100 percent of the outstanding common stock of the Company, or 25,000 shares at \$100 per share.

#### Dividends to Stockholders

On June 29, 2005, the Company paid an extraordinary dividend of \$20,000,000 to AIG after receiving approval from the Delaware Department of Insurance on June 3, 2005. There were no dividends paid in 2004 or 2006.

#### Management

During the Board of Directors meeting of November 18, 2004, a resolution was passed to restate the bylaws. The bylaws were restated as of April 27, 2005 and filed with the Commissioner's office as of June 16, 2005. The by-laws state that the business and affairs shall be managed by a Board of Directors consisting of five or more directors. The directors shall be elected at the annual meeting of the stockholders and shall hold office until a successor is elected and qualified. It is not necessary for the directors to be stockholders.

The elected directors of the Company at December 31, 2006, were as follows:

| <u>Directors</u>            | <u>Principal Occupation or<br/>Other Business Affiliation</u>                 |
|-----------------------------|---|
| M. Bernard Aidinoff         | Retired partner, Sullivan & Cromwell  |
| Mary Jane Bartolotta Fortin | Executive Vice President and Chief<br>Financial Officer of the Company        |
| David L. Herzog             | Senior Vice President and Comptroller, AIG                                    |
| Rodney O. Martin, Jr.       | AIG Executive Vice President Life, Chief<br>Operating Officer World Wide Life |
| Gary D. Reddick             | AIG Senior Vice President World Wide Life                                     |
| Christopher J. Swift        | AIG Vice President Life – Vice President<br>and Chief Financial Officer Life  |
| Matthew E. Winter           | President and Chief Executive Officer   |

The principal officers of the Company at December 31, 2006, were as follows:

Officers

|                             |  |
|-----------------------------|--|
| Rodney O. Martin, Jr.       | Chairman of the Board  |
| Matthew E. Winter           | President and Chief Executive Officer                        |
| Mary Jane Bartolotta Fortin | Executive Vice President and Chief<br>Executive Officer      |
| Gary D. Reddick             | Executive Vice President and Chief<br>Administrative Officer |
| Robert M. Beuerlein         | Senior Vice President and Chief Appointed<br>Actuary         |
| Robert F. Herbert, Jr.      | Senior Vice President, Treasurer and<br>Controller           |
| Kyle L. Jennings            | Senior Vice President and General Counsel                    |
| Harry R. Miller             | Senior Vice President  |



|                     |   |
|---------------------|---|
| David S. Jorgensen  | Vice President and Assistant Secretary      |
| Deanna D. Osmonson  | Vice President and Chief Privacy Officer    |
| Richard W. Scott    | Vice President and Chief Investment Officer |
| David S. Brasington | Vice President and Chief Compliance Officer |
| Elizabeth M. Tuck   | Secretary                                   |

### Control

The ultimate controlling person is AIG, a Delaware corporation, with its principal place of business at 70 Pine Street, New York, NY 10270. AIG is a holding company, controlled by its board of directors on behalf of its shareholders.

### **HOLDING COMPANY SYSTEM**

As previously noted, the Company is a member of the AIG holding company system. AIG is a publicly traded U.S. based international insurance holding company, domiciled in Delaware, operating in approximately 130 countries and jurisdictions around the world.

AIG's operating subsidiaries form one of the largest global financial services institutions, providing a broad product and service portfolio consisting of life and property/casualty insurance, retirement services, investment management, and financial products to institutional, corporate and retail customers. AIG's life insurance companies operate in three core business lines: Domestic Life, Domestic Retirement Services and International Life and Retirement Services. As a member of AIG's Domestic Life Division, the Company benefits extensively from AIG's production sources, service facilities and underwriting and management experience.

The AIG holding company organizational chart reflects over 300 entities. The Company's direct parent is AIG. The company does not hold direct or indirect ownership of any subsidiary companies<sup>[BCA1]</sup>. A modified organizational chart below reflects significant affiliated entities with which the Company conducts business.

American International Group, Inc.  
AIG Property Casualty Group, Inc.  
AIG Commercial Insurance Group, Inc.  
Commerce and Industry Insurance Company  
AIG Life Holdings (International) LLC  
American International Reinsurance Company, Ltd.  
American International Assurance Company, Ltd.  
AIG Life Insurance Company (79%) \*  
AIG Life Insurance Company of Puerto Rico  
**Delaware American Life Insurance Company**  
AIG Capital Corporation  
AIG Global Asset Management Holdings Corp.  
AIG Global Investment Corp.

21% Commerce and Industry Insurance Company

## **MANAGEMENT AND SERVICE AGREEMENTS**

The Company was a party to numerous inter-company agreements, which were disclosed by the Company in its Form B Registration Statement filings with the Delaware Department of Insurance. The agreements of significance are summarized as follows:

### **Service and Expense Agreement**

On February 1, 1974, AIG entered into a Service and Expense Agreement among several affiliated companies. Addendum No. 2 added the Company to the agreement as of September 23, 1975. Additional amendments, 35 in total, primarily added parties to the agreement. Pursuant to the agreement, the companies are all subsidiaries of AIG and share among

themselves and with certain other subsidiaries and affiliates of AIG certain expenses, equipment, office space, services and personnel furnished by AIG. The companies shall reimburse AIG on a quarterly basis at no greater than cost.

The review of related party transactions found that the Company was not settling its inter-company balances in accordance with the quarterly requirement of the Service and Expense Agreement.

**It is recommended that the Company settle its inter-company balances in accordance with the Service and Expense Agreement.**

#### Tax Payment Allocation Agreement

The Company participates in the consolidated federal income tax return of AIG and its domestic subsidiaries based upon a Tax Payment Allocation Agreement effective January 1, 1992, as amended on January 1, 1994. The agreement provides for the Company's taxes to be calculated as if it filed a separate tax return. Installment payments shall be made by the Company to AIG on or about April 15, June 15, September 15, and December 15. All inter-company balances shall be settled within 90 days after such payment or refund receipt.

#### Investment Advisory Agreement

Effective April 1, 1999, the Company entered into an Investment Advisory Agreement with AIG Global Investment Corp. AIG Global has full power to supervise and direct the investment and reinvestment of the cash, securities and other property. Compensation to AIG Global is a percentage based on the average market value of the Company's account.

### Short Term Investment Pool Participation Agreement

Effective October 31, 2002, the Company was added as a party to the Short Term Investment Pool Participation Agreement dated as of April 28, 1999, among American General Investment Management, L.P., as manager, AIG Life Insurance Company, other entities within the American International Group, Inc., and State Street Bank and Trust Company. There were four amendments to the agreement; the fourth dated January 1, 2002, replaces the manager as AIG Global Investment Corp. The Agreement permits the parties to invest funds in three short-term pools, and is intended to improve the rate of return on each party's investment by pooling its assets with other affiliates.

### Administration Services Agreement

On December 1, 2002, the Company entered into an Administrative Services Agreement with AIG Business Processing Services, Inc. (BPSI), an affiliate under the common control of AIG. Administrative services provided by BPSI under the agreement include data entry of information from electronically imaged documents, indexing processes, basic policyholder service updates and changes, title changes, requests for policy benefits/disbursements, preparation of simple policyholder correspondence, processing of simple uncontested claims, and call center services. Accounting services provided by BPSI include accounts payable processing, matching of invoices to the requisition documentation and performance of ministerial processing relating to preparation of payment data, bank account reconciliation, and reconciliation of suspense accounts. The term of the agreement is three years from effective date, and renewable annually thereafter.

### **TERRITORY AND PLAN OF OPERATION**

The Company is authorized to write life and accident and health business in the District of Columbia and is licensed in all states except Minnesota, Missouri, New Hampshire, New York, and North Carolina.

The Company markets group life, accidental death and dismemberment, medical, dental and long term disability business through the AIG multinational sales force. The customer focus of this business is on executives working outside their own country of citizenship and residing outside the United States.

The Company asserted it has two licensed and appointed agents. During the review of agents licensing, it was noted that the listing of licensed and appointed agents provided by the Company did not reconcile with the listing provided by the Delaware Department of Insurance (the Department). This was noted in the prior report on examination.

**It is again recommended that the Company comply with 18 Del. C. § 1715 and § 1716 and properly notify the Department of appointment and termination of agents.**

### **GROWTH OF THE COMPANY**

The following information was obtained from the Company's filed Annual Statements for the period under examination.

|      | <b>Net Admitted</b>  | <b>Capital</b>            | <b>Gross Written</b>  |                          |
|------|----------------------|---------------------------|-----------------------|--------------------------|
|      | <b><u>Assets</u></b> | <b><u>And Surplus</u></b> | <b><u>Premium</u></b> | <b><u>Net Income</u></b> |
| 2006 | \$80,450,166         | \$25,812,389              | \$22,984,022          | \$2,802,568              |
| 2005 | 77,955,369           | 23,373,726                | 25,411,137            | 3,306,693                |
| 2004 | 97,006,132           | 39,187,880                | 29,070,031            | 3,657,048                |
| 2003 | 94,086,916           | 34,974,932                | 28,065,380            | 1,144,669                |

The Company's net admitted assets increased by 3.2 percent from 2005 to 2006 due to growth in invested assets, primarily short-term investments. Capital and surplus increased

approximately 10 percent from 2005 to 2006, primarily due to the net gain from operations of \$2.7 million. The decrease in net income from 2005 to 2006 was not financially significant. Gross premiums written decreased from 2005 to 2006 by \$2.4 million, primarily in the group life line of business.

The decrease in net admitted assets and capital and surplus from 2004 to 2005 were primarily the result of the \$20 million dividend payment to the shareholder. The decrease in gross written premiums from 2004 to 2005 was primarily in the group life line of business.

The increase in net income from 2003 to 2004 resulted from insurance and annuity benefits decreasing by \$1.6 million, primarily due to a decrease in group life death benefits and reserves, and a decrease in individual annuity reserves. In addition, the experience rating refund decreased \$1.5 million due to improved experience over prior year.

### **REINSURANCE**

The following describes the Company's reinsurance program as of December 31, 2006:

#### **Assumed**

The Company assumes life insurance from an affiliate, AIG Life Insurance Company of Puerto Rico. The life business is assumed under yearly renewable term contracts for individual and group business and under coinsurance agreements for individual business, which have been in place since 1980.

The Company also assumes group accident and health business from AIG Life Insurance Company of Puerto Rico. The business is assumed under two agreements executed in 1995 and 1998. This business is retro ceded 100 percent to Hartford Life and Accident Insurance Company, a non-affiliated company.

#### **Ceded**

The Company cedes both group and individual life business to three affiliates and numerous non-affiliates. The business is ceded under various yearly renewable term, coinsurance and catastrophe reinsurance agreements.

Total reserve credits taken in 2006 for ceded life business amounted to \$7,126,393, with affiliated companies accounting for \$529,659 of the aforementioned reserve credits. The only treaties entered into during the period under examination were catastrophe agreements. All other reinsurance agreements were in place prior to the period covered by the examination.

Accident and health business is ceded to three reinsurers; however, Hannover Ruckversicherungs AG of Germany assumes the bulk of the accident and health business ceded by the Company.

The Company's maximum retained liability as of December 31, 2006 was \$2,500,000 on individual life policies, and \$3,500,000 on term policies, and \$5,000,000 on universal life policies. The Company may, on a selected case basis, retain up to \$7,000,000 for term policies and up to \$10,000,000 on universal life policies with approval by the Retention Limit Advisory Group. The maximum reinsurance coverage provided by the ceding program is \$50,000,000.

### **ACCOUNTS AND RECORDS**

The Company's trial balance and adjusting entries were traced to the Annual Statement, and items were linked from schedule to schedule. The verification of posting from books of original entry was performed during the course of examination on the individual account components. The statutory-basis financial statements of the Company are audited annually by PricewaterhouseCoopers, an independent certified accounting firm. The Company's accounts and records are also subject to review by the internal audit department of AIG. Based on the

examination review of Annual Statement classifications and subsequent discussions with management, the accounting system and procedures conformed with insurance accounting practices and requirements.

A comprehensive organizational and process flow mapping was performed by INS Services, Inc., Philadelphia, PA., an internal control system specialist team. The organizational and process flow mapping includes reviews and understanding of corporate structure, underwriting, distribution, administration, computer application systems, claims, cash receipts and disbursements, taxes, investments, actuarial, general ledger and annual statement.

In addition, an assessment was performed by INS Services, Inc. of the overall control environment. INS Services, Inc. examined the Company's responses to the Examination Planning Questionnaire Exhibit C, interviewed management, reviewed systems, performed judgmental and statistical samples of Company records evidencing execution of the Company's information systems control procedures, and performed various other tests of controls to assess the pervading control environment. As a result of the examination performed by INS Services, Inc., the assessment of the overall control risk related to information systems controls at the Company is low for those policies and procedures that had been in place as of December 31, 2006. In some areas, a less substantive examination approach was taken in response to the risk rating of low.

The Company has several offices located throughout the country. Houston is the Administrative Office where financial accounting and Company officers are located. The Company has several policy administrative systems, segregated by product line. Systems have changed over time through acquisition and development. Various systems are utilized to process claims, which are determined by the administrative system used when the policy is issued.



Administrative functions for cash receipts are located in Springfield, IL, and Neptune, NJ (Group), while treasury functions are maintained in Houston for overall control. The Company utilizes several third party administrators for administration and collection of cash for certain products. The Cash Disbursement Control System is maintained in Livingston, NJ, by AIG Corporate Treasury and controlled by Houston treasury.

All investment transactions are initiated and monitored by AIG Global Investment Group (AIGGIG). AIGGIG comprises a group of international companies, which provide investment advice and market asset management products and services to clients around the world. Investment management operations and investment accounting are performed in New York, Houston and Los Angeles by AIG Global Investment Corp. (AIGGIC). AIGGIC is an indirect wholly-owned subsidiary of AIG, incorporated in the state of New Jersey. AIGGIC provides investment management services to both AIG companies and non-AIG companies. Investment transactions are reviewed and approved by the Company's board of directors quarterly.

The Company utilizes the ABC (Accounting, Budgeting and Cost) general ledger system, which is a mainframe based system located in Dallas, TX, with IT support in Houston. Manual entries to the ledger can be made in Houston and from various administrative offices. Beginning January 1, 2007, the Company initiated the SAP accounting system for general ledger functions.

The examination utilized ACL analysis for reconciliation and sampling procedures for premiums written, paid claims, policy loans, and reserve transactions. ACL analysis was also utilized for reconciliation of the Company's general ledger and trial balance and transaction roll-up testing.

## **FINANCIAL STATEMENTS**

The following statements show the assets, liabilities, surplus and other funds of the Company, as determined by this examination, as of December 31, 2006:

Analysis of Assets  
Liabilities, Surplus and Other Funds  
Summary of Operations  
Capital and Surplus Account  
Analysis of Examination Changes

It should be noted that the various schedules and exhibits may not add to the totals shown due to rounding.

### **Analysis of Assets** **As of December 31, 2006**

|   | <u>Assets</u>       | Nonadmitted<br><u>Assets</u> | Net Admitted<br><u>Assets</u> | <u>Notes</u> |
|---|---------------------|------------------------------|-------------------------------|--------------|
| Bonds   | \$53,751,176        | \$0                          | \$53,751,176                  |              |
| Preferred stocks  | 3,969,423           | 0                            | 3,969,423                     |              |
| Cash and short-term investments                                       | 15,650,161          | 0                            | 15,650,161                    |              |
| Contract loans  | 1,405,656           | 0                            | 1,405,656                     |              |
| Investment income due and accrued                                     | 912,424             | 0                            | 912,424                       |              |
| Uncollected premiums and agents' balances<br>in course of collection  | 2,513,259           | 0                            | 2,513,259                     |              |
| Other amounts receivable under reinsurance<br>Contracts               | 128,708             | 0                            | 128,708                       |              |
| Current federal and foreign income tax recoverable                    | 1,699,510           | 0                            | 1,699,510                     |              |
| Net deferred tax asset  | 593,501             | 329,050                      | 264,451                       |              |
| Guaranty funds receivable or on deposit                               | 47,289              | 0                            | 47,289                        |              |
| Receivable from parent, subsidiaries, and affiliates                  | 108,109             | 0                            | 108,109                       |              |
| Aggregate write-ins for other than invested assets:<br>Agent advances | 1,425               | 1,425                        | 0                             |              |
| Totals  | <u>\$80,780,641</u> | <u>\$330,475</u>             | <u>\$80,450,166</u>           |              |

**Liabilities, Surplus and Other Funds**  
**As of December 31, 2006**

|   |                            | <u>Notes</u> |
|---|----------------------------|--------------|
| Aggregate reserve for life contracts                              | \$32,277,356               | 1            |
| Aggregate reserves for accident and health contracts              | 1,632,053                  |              |
| Liability for deposit-type contracts                              | 6,854,334                  |              |
| Contract claims:  |                            |              |
| Life  | 1,529,706                  |              |
| Accident and health   | 1,513,311                  |              |
| Premiums and annuity considerations received in advance           | 280,476                    |              |
| Provision for experience rating refunds                           | 1,033,554                  |              |
| Other amounts payable on reinsurance ceded                        | 72,090                     |              |
| Interest Maintenance Reserve                                      | 730,447                    |              |
| Commissions to agents due or accrued                              | 277,600                    |              |
| Commissions and expense allowances payable on reinsurance assumed | 49,313                     |              |
| General expenses due or accrued                                   | 490,000                    |              |
| Taxes, licenses and fees due or accrued                           | 273,398                    |              |
| Unearned investment income  | 10,173                     |              |
| Amounts withheld or retained by company as agent or trustee       | 3,998                      |              |
| Remittances and items not allocated                               | (195,057)                  |              |
| Asset valuation reserve   | 399,284                    |              |
| Reinsurance in unauthorized companies                             | 112,904                    |              |
| Payable to parent, subsidiaries and affiliates                    | 6,928,045                  |              |
| Drafts outstanding  | 364,792                    |              |
| Total liabilities   | <u>\$54,637,777</u>        |              |
| Common capital stock  | <u>\$ 2,500,000</u>        |              |
| Gross paid in and contributed surplus                             | \$35,922,196               |              |
| Unassigned funds (surplus)  | (12,609,807)               |              |
| Surplus   | <u>\$23,312,389</u>        |              |
| Total capital and surplus   | <u>\$25,812,389</u>        |              |
| Total   | <u><u>\$80,450,166</u></u> |              |

**Summary of Operations**  
**For the Year Ended**  
**December 31, 2006**

|  |                            |
|--|----------------------------|
| Premiums and annuity considerations for life and accident and health contracts   | \$19,597,596               |
| Net investment income  | 4,188,628                  |
| Amortization of Interest Maintenance Reserve   | 108,067                    |
| Commissions and expense allowances on reinsurance ceded  | 180,148                    |
| Reserve adjustments on reinsurance ceded   | (4,436)                    |
| Total  | <u>\$24,070,003</u>        |
| Death benefits   | \$ 2,592,485               |
| Annuity benefits   | 666,288                    |
| Disability benefits and benefits under accident and health contracts   | 6,954,065                  |
| Surrender benefits and withdrawals for life contracts  | 726,924                    |
| Interest and adjustments on contract or deposit-type contract funds  | 2,370,839                  |
| Increase (decrease) in aggregate reserves for life and accident and health contracts   | (4,491,866)                |
| Total  | <u>\$ 8,818,735</u>        |
| Commissions on premiums, annuity considerations and deposit-type contract funds  | 1,077,685                  |
| Commissions and expense allowances on reinsurance assumed  | 703,948                    |
| General insurance expenses   | 4,955,806                  |
| Insurance taxes, licenses and fees, excluding federal income taxes   | 732,376                    |
| Increase in loading on deferred and uncollected premiums   | 3,378                      |
| Aggregate write-ins for deductions:  |                            |
| State fines and penalties  | 7,192                      |
| Total  | <u>\$16,299,120</u>        |
| Net gain from operations before dividends to policyholders and federal income taxes  | \$ 7,770,883               |
| Dividends to policyholders   | <u>136</u>                 |
| Net gain from operations after dividends to policyholders and before federal income taxes  | \$ 7,770,747               |
| Federal income taxes incurred  | <u>5,022,059</u>           |
| Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains or (losses) | \$ 2,748,688               |
| Net realized capital gains or (losses) less capital gains tax and transferred to the IMR   | <u>53,880</u>              |
| Net income   | <u><u>\$ 2,802,568</u></u> |

**Capital and Surplus Account**

|   |                            |
|---|----------------------------|
| Capital and surplus December 31, previous year                | <u>\$23,373,726</u>        |
| Net income  | \$ 2,802,568               |
| Change in net deferred income tax                             | 7,582                      |
| Change in non-admitted assets and related items               | (279,123)                  |
| Change in liability for reinsurance in unauthorized companies | (97,067)                   |
| Change in asset valuation reserve                             | 4,703                      |
| Net change in capital and surplus for the year                | <u>\$ 2,438,663</u>        |
| Capital and surplus December 31, current year                 | <u><u>\$25,812,389</u></u> |

**Analysis of Examination Changes**  
**December 31, 2006**

No financial changes were made for examination report purposes.

**NOTES TO THE FINANCIAL STATEMENTS**

**Note 1**

**Aggregate Reserve for Life Contracts**

**\$ 32,277,356**

This liability is reported on Page 3, Line 1 and in Exhibit 5 of the Company's 2006 General Account (GA) Annual Statement. The reserve breakdown in Exhibit 5, by type of benefit, is as follows:

|                             |                      |
|-----------------------------|----------------------|
| Life Insurance              | \$ 25,988,596        |
| Annuities                   | 4,183,344            |
| Accidental Death Benefits   | 1,760                |
| Disability – Active Lives   | 33,568               |
| Disability – Disabled Lives | 1,948,783            |
| Miscellaneous Reserves      | <u>121,305</u>       |
| Grand Totals (Net)          | <u>\$ 32,277,356</u> |

**General**

The period under examination covered calendar years 2004, 2005, and 2006, with primary emphasis of the examination being balance sheet items as of December 31, 2006 and an in-depth review of the asset adequacy / cash flow testing analysis (performed annually as part of the Actuarial Opinion Memorandum). The Company holds reserves primarily for traditional ordinary life, universal life, immediate annuities, structured settlement annuities and supplementary contracts. Smaller reserves are held for accident and health contracts and life and accident and health claims. The Company's appointed actuary concluded that reserves were adequate and that no additional actuarial reserves were required as of December 31, 2006. Based

on the review of the asset adequacy / CFT analysis by the consulting actuary, INS Consultants, Inc. (INS), that conclusion has been accepted for the purpose of this report.

The Company's traditional life and universal life businesses are administered using the LifeComm system. Payout annuities are administered using the Repetitive Payout System (RPS). Based on discussions between INS and the examiner, control test sample sizes were determined assuming a medium risk of material misstatement and an intended high reliance on internal controls. For substantive testing, INS consistently uses an intended high reliance on internal controls with an appropriate risk of material misstatement as determined by the actuary for actuarial liabilities. Over 60 percent of the LifeComm reserves were held for universal life (UL) products. UL reserves are predominantly driven by the account value, rather than factors. Thus, control testing of the LifeComm system was not necessary. Substantive sample sizes assuming no reliance on controls were less than control test sample sizes for RPS. As a result, no control testing was performed for RPS. INS selected substantive samples assuming no reliance on internal controls. Due to the systematic calculation of UL reserves, a judgmental sample was selected for data validity and reserve verification.

Underlying data for contracts in the samples was verified by the examiners. No exceptions were noted. INS verified the reserve methodology and reserve calculations for all contracts without exception.

INS performed two inclusion tests for the life and annuity business. No exceptions were noted. In addition, roll forward analysis, which checked all components of the account value calculation for reasonableness, was reviewed for the Company's UL segment. The results of these tests indicated that the Company's valuation files are complete.

As part of the annual reserve certification process, the Company's valuation runs and supporting work papers for the reserves reported in Exhibits 5 and 7 were reviewed. INS found the work papers to be in order.

The primary risks associated with Exhibit 5 business are adverse mortality, asset default, interest rate volatility and mismatching of asset and liability cash flows. These risks were further reviewed by evaluating the 2006 Actuarial Opinion Memorandum (AOM). Based on that review, INS accepted the Company's conclusion that additional reserves are not required.

Each of the above items is discussed below in further detail.

|                             |                      |
|-----------------------------|----------------------|
| <b>Life Insurance (Net)</b> | <b>\$ 25,988,596</b> |
|-----------------------------|----------------------|

Exhibit 5, Life Insurance reserves can further be broken down by product type as follows:

|                             |                      |
|-----------------------------|----------------------|
| Universal life-LifeComm     | \$ 13,854,005        |
| Group Universal Life-Manual | 7,937,328            |
| Traditional ordinary life   | 7,177,653            |
| All other life insurance    | <u>1,651,186</u>     |
| Total (Gross)               | \$ 30,620,172        |
| Reinsurance ceded           | <u>4,631,576</u>     |
| Total (Net)                 | <u>\$ 25,988,596</u> |

The Company provided detail audit reports from the LifeComm system for each sampled contract. For most policies in the sample, the resulting reserve was the cash surrender value; however, INS also verified the underlying UL CRVM reserve for each contract without exception. The Company holds an additional reserve equal to half a month interest on the year-end 2006 account value. INS concluded that the Company's UL reserves meet minimum valuation standards.

Group UL reserves are held for one case that is not administered on LifeComm. This case is administered on a manual basis. Details are maintained in an Excel spreadsheet. The

Company holds the account value as the reserve. The Company's valuation certificate work papers provided a worksheet that tracks the account value, death benefit, interest credited rates and premiums paid to date. The resulting reserve appears reasonable.

The Company's traditional ordinary life business is administered on the LifeComm system. The products consist mostly of group term and individual life plans. INS selected a sample of 23 life contracts for data validity testing and reserve verification. The sample consisted of four group term plans and 19 whole life plans. The Company provided detail reserve audit reports for all but three contracts. The Company holds reserves for group term equal to the interpolated net unearned premium, using semi-continuous functions. The whole life reserves were based on the CRVM method, using semi-continuous functions. INS verified reserves for each contract without exception. INS concluded that the Company's ordinary life reserves meet minimum valuation standards.

The remaining GA Exhibit 5, life reserve, is held for single premium life (\$182,628), employee benefits (\$23,003), retired lives reserves (\$966,485), reinsurance assumed (\$478,542) and miscellaneous (\$528). These reserve segments remained relatively flat during the period under examination. Based on work in the prior examination and the trend analysis, the reserves appear reasonable and no further analysis was necessary.

**Reinsurance ceded**

**\$ 4,631,576**

Reserve ceded reserve credits appeared reasonable. Amounts reported in Exhibit 5 were also reconciled with amounts shown in Schedule S without exception.

Based on the above analysis, INS accepted the Exhibit 5 life insurance reserves (net) as stated.



**Annuities (Net)** **\$ 4,183,344**

The Company's Exhibit 5, Annuity can be broken down as follows:

|                   |                     |
|-------------------|---------------------|
| Total (Gross)     | \$ 6,678,160        |
| Reinsurance Ceded | <u>2,494,816</u>    |
| Total (Net)       | <u>\$ 4,183,344</u> |

The Company's annuity reserves were held for single premium immediate annuities (SPIA) and for structured settlements (SS). These products are administered using the RPS system. INS selected a sample of eight contracts for data validity and reserve verification. INS verified reserves for all contracts in the sample without exception.

Based on the above analysis, INS accepted the Exhibit 5 annuity reserves as stated.

**Accidental Death Benefits (Net)** **\$ 1,760**  
**Disability - Active Lives (Net)** **\$ 33,568**

These reserves are held for the respective benefits provided under the Company's ordinary and universal life insurance products. A trend analysis of these reserves indicated a reasonable pattern over the examination period. Based on materiality, no additional testing was deemed necessary.

Based on the above discussion, INS accepted the Exhibit 5 accidental death benefit and disability - active lives reserves as stated.

**Disability - Disabled Lives (Net)** **\$ 1,948,783**

These reserves are held for the waiver of premium benefits on disabled lives. The reserves consist of individual (\$855,254) and group (\$1,035,000) life claims and (\$58,529) for incurred but not reported (IBNR) group life claims. The Company holds 75 percent of the face amount for the group life claims. As a reasonableness check, the Company calculates a reserve

based on the average age and duration of the block of group business. The resulting reserve, calculated based on the 1970 Intercompany Group Life Disability table (also known as the Krieger table) is about 41 percent of the face amount. In the previous exam, INS reviewed the calculation and concluded that the Company's group life disabled lives reserves appear conservative. A trend analysis of the other disabled reserves indicated a reasonable pattern over the examination period and no further review was deemed necessary.

Based on the above analysis and discussion, INS accepted the Exhibit 5 disability - disabled lives reserves as stated.

**Miscellaneous Reserves** **\$ 121,305**

Exhibit 5 miscellaneous reserves can be further broken down as follows:

|                       |                   |
|-----------------------|-------------------|
| Deficiency Reserves   | \$ 58,763         |
| Group Conversion      | 32,473            |
| Substandard           | <u>30,069</u>     |
| Total (Gross and Net) | <u>\$ 121,305</u> |

The deficiency reserves are held for older traditional life products. A trend analysis of the deficiency, substandard and group conversion reserves over the examination period indicated a steady decline and appeared reasonable given that the Company's life insurance business consists of closed blocks of business. The miscellaneous reserves were immaterial and no further analysis was deemed necessary.

Based on the above discussion and analysis, INS accepted the Exhibit 5 miscellaneous reserves as stated.

**Exhibit 5, Grand Total (Net)**

**\$ 32,277,356**

Reserves were reviewed for compliance with the standard valuation and non-forfeiture laws, applicable National Association of Insurance Commissioners' Actuarial Guidelines and Model Regulations. Reserves for sampled life insurance and annuity contracts were calculated in accordance with standard actuarial practice. Reserve methodology was reasonable and consistent.

Based on previous analysis and discussions, INS concluded that the aggregate reserve for life contracts as reported by the Company on Page 3, Line 1 and in Exhibit 5 of the December 31, 2006 Annual Statement appears fairly stated. It has been accepted for the purpose of this report.

**COMPLIANCE WITH PRIOR REPORT**

There were six recommendations made in the prior examination report. The Company complied with all prior examination recommendations with the exception of the following:

1. As disclosed under the Territory and Plan of Operations section of this report, the review of agents licensing noted that the listing of licensed and appointed agents provided by the Company did not reconcile with the listing provided by the Delaware Department of Insurance (the Department). The Company had not complied with 18 Del. C. § 1715 and § 1716 to properly notify the Department of appointment and termination of agents.

### **RECOMMENDATIONS**

1. It is recommended that the Company settle its inter-company balances in accordance with the Service and Expense Agreement. (Management and Service Agreements, p. 7)
2. It is again recommended that the Company comply with 18 Del. C. § 1715 and § 1716 and properly notify the Department of appointment and termination of agents. (Territory and Plan of Operation, pp. 9 and 23)

### **CONCLUSION**

As a result of this examination, the financial condition of the Company, as of December 31, 2006, was determined to be as follows:

|                     |                     |
|---------------------|---------------------|
| Admitted Assets     | <u>\$80,450,166</u> |
| Liabilities         | \$54,637,777        |
| Capital and Surplus | <u>25,812,389</u>   |
| Total               | <u>\$80,450,166</u> |

Since the last examination as of December 31, 2003, total assets have decreased \$13,636,750. Liabilities have decreased \$4,474,207, and capital and surplus have decreased \$9,162,543 in the same period.

### **ACKNOWLEDGMENT**

The cooperation and assistance rendered by the officers and employees of the Company during the course of the examination are hereby acknowledged.

In addition to the undersigned, Giles W. Larkin, CFE, Don Hollier, CFE, Joseph M. Funkhouser, Gwendolyn J. Douglas, CFE, CIE, Joe Torres, CFE, James Boswell, CCP, and Paul Berkebile, CFSA, INS Services, Inc., participated in portions of the examination. Frank G. Edwards, Jr., FSA, MAAA, INS Consultants, Inc., completed the actuarial portion of this examination.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Jean Alton", is written over a horizontal line.

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Jean Alton, CFE  
Examiner in Charge  
Department of Insurance  
State of Delaware

### **SUBSEQUENT EVENTS**

On December 14, 2007, the Department acknowledged by letter the receipt of notification that Commerce and Industry Insurance Company is selling its 21 percent share of AIG Life Insurance Company to AIG. It was noted that AIG will contribute those shares to its wholly owned subsidiary, AIG Life Holdings (US), Inc. and then AIG Holdings will contribute those shares to its wholly owned subsidiary, AGC Life Insurance Company, a Missouri-domiciled insurer. The letter states that, with no change of control resulting from the transaction, the Department does not have any concern. Management anticipates that Commerce and Industry will sell its ownership interest in AIG Life Insurance Company by year end 2007.